United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF & APPENDIX

75-5004

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In the Matter of
VISUAL SOUNDS, INC.,

Debtor,

GENERAL PACKAGING SERVICE, INC.,

Appellant.

IN BANKRUPTCY—ON APPEAL FROM ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

SAT BELOW: HON. DUDLEY B. BONSAL, U.S.D.J., HON. ASA S. HERZOG, BANKRUPTCY JUDGE

BRIEF AND APPENDIX ON BEHALF OF APPELLANT

MILLER & BUSH,
405 Lexington Ave., New York, N. Y.,
and
ROBERT ALAN VORT,
1180 Raymond Blvd., Newark, N. J.,
Attorneys for General Packaging Service, Inc.,

ROBERT ALAN VORT
On the Brief

N. J. Appellate Printing Co., Inc., Woodbridge, N. J. (201) 636-2030

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APPENDIX

This appeal is taken from an order of the United States District Court for the Southern District of New York, *per* Hon. Dudley B. Bonsal (Aa41)* which affirmed an order of Bankruptcy Judge Asa S. Herzog of that court (Aa33). Neither the opinion of Judge Bonsal (Aa35) nor the opinion of Judge Herzog (Aa27) has been reported.

This Court has jurisdiction under Bankruptcy Act §24(a), 11 U.S.C. §47(a). *Ackert v. Baltimore & Ohio R. Co.*, 115 F.2d 455, 456 (4th Cir.) *cert. den.* 311 U.S. 717 (1940). 2 Collier on Bankruptcy ¶24.05 (14th ed. 1975). *Cf., In Matter of Federal Photo Engraving Corp.*, 54 F.2d 628, 629 (2d Cir. 1931).

ISSUES PRESENTED

1. Whether the failure of the Bankruptcy Court to make a finding that the adverse claim raised was "substantial" or "merely colorable" as required by Bankruptcy Rule 752 necessitates reversal.

2. Whether the assertion of title, by a seller under a contract which the Bankruptcy Court termed "ambiguous" and which contains several conditions precedent none of which were satisfied by the debtor-buyer, discloses a contested matter of right involving some fair doubt either of fact or of law.

3. Assuming, *arguendo*, the propriety of the Bankruptcy Court's exercise of summary jurisdiction, whether title to the securities in question had passed from seller to buyer when both parties had sought to rescind their only effective agreement and the conditions precedent to the

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* Aa refers to Appellant's Appendix.

effectiveness of their subsequent settlement agreement were never satisfied.

4. Whether the proceedings in the Bankruptcy Court are void *ab initio* because no evidence had been presented prior to the issuance of the order to show cause and because no complaint has ever been filed by the debtor. [This point has not been argued previously although these facts were called to the attention of the District Court.]

STATEMENT OF THE CASE

A. *Nature of Case*

This is a Chapter XI proceeding in which Visual Sounds, Inc., the debtor-in-possession (hereinafter "V.S.I." or "debtor"), has sought and obtained an order directing one Harold G. Israelson to surrender to V.S.I. common stock of General Magnetic Tape Co., Inc. (hereinafter "Magnetic Tape") held by Israelson as "gratuitous custodian" pursuant to an agreement between V.S.I. and General Packaging Service, Inc. (hereinafter "G.P.S.").

B. *Procedural History*

This proceeding was commenced by the issuance on August 13, 1974 of an order signed by Hon. Roy Babitt directing Israelson and G.P.S. to show cause why they should not be directed to turn over to the debtor the Magnetic Tape stock in their possession (Aa1). This order to show cause was issued upon the unattested application of the debtor signed by its firm of attorneys (Aa1, Aa3). The debtor never filed a complaint.

Edwin Goddard, an officer of G.P.S., gave an affidavit in response to the order to show cause and in opposition to the exercise of summary jurisdiction by the Bankruptcy Court (Aa15). Thereafter, Harold Fischman, secretary of the debtor and its attorney in charge of the Chapter XI proceedings, filed an affidavit in support of the application for the turnover order (Aa21). This affidavit stated no facts affirmatively but only questioned the facts as stated by Goddard. It also incorporated by reference the statement of facts in the brief submitted then for the first time by V.S.I. in support of the motion (Aa25).

No oral testimony was presented to or requested by the Bankruptcy Court which ruled that the debtor was

entitled to possession of the Magnetic Tape stock (Aa27) and so ordered (Aa33). On appeal to the District Court, that order was affirmed (Aa41). This appeal ensued (Aa42).

G.P.S. then applied to the District Court for a stay pending review by this Court. Judge Bonsal denied the motion but ordered that any application of the debtor to pledge, hypothecate or otherwise encumber the Magnetic Tape stock pending this Court's decision on this appeal be made on notice to G.P.S. Neither party has appealed that order. The debtor now has physical possession of the stock.

C. *Statement of Facts*

G.P.S. owned common stock of Magnetic Tape. In March 1972 it entered an agreement to sell this stock to V.S.I. in consideration for payments of money to be made over time, the amount of which depended upon Magnetic Tape's profitability (Aa17-Aa18). V.S.I. failed to make the scheduled payments (Aa18), and G.P.S. then instituted litigation in the Superior Court of New Jersey for rescission of this agreement and for other relief (Aa18-Aa19). V.S.I. thereafter filed a lawsuit in the United States District Court for the Southern District of New York seeking return of the money it had previously paid for the Magnetic Tape stock. Neither action was prosecuted to final judgment; instead, on October 2, 1973 the parties entered a settlement agreement (Aa5-Aa9) the effectiveness of which was predicated upon the satisfaction of several conditions precedent (Aa7). In relevant part paragraphs 4(a) and 4(d) of the agreement provide:

> "It is a condition precedent to the effectiveness of this Settlement Agreement and Releases that:

(a) VSI agrees and guarantees to pay its promissory note payable to GPS in the principal amount of Fifty Thousand Dollars ($50,000) which is now held by the Marine Midland Bank of New York and which is due on the 1st day of April, 1974. VSI undertakes and agrees that it will take the necessary steps to keep KINNE [president of VSI] and GODDARD harmless from their respective guarantees or obligations to the said Fifty Thousand Dollars ($50,000) promissory note.

* * *

"(d) VSI agrees to pay the sum of Twenty-Five Thousand Dollars ($25,000) to GPS, and such payments will be made at the rate of One Thousand Dollars ($1,000) per month starting on the 15th day of each month consecutively thereafter for twelve (12) months, and the balance then unpaid will be paid on the 15th day of the thirteenth month."

Paragraph 5(a) of the agreement (8a) provides further:

"All of the issued and outstanding stock of GMT [General Magnetic Tape] shall be delivered to Harold G. Israelson, Esq., of Israelson & Streit, 521 Fifth Avenue, New York, New York; and the said Harold G. Israelson, Esq. will act merely as a gratuitous custodian of such stock certificates of GMT and not as an escrow agent, nor as a pledgeholder, nor as a guarantor, nor in any other manner or capacity, but solely as custodian of those stock certificates. The said stock certificates shall be returned promptly to VSI upon payment of the Twenty-Five Thousand Dollars ($25,000) referred to in paragraph 4(d) above. The said custodian account shall not be, nor considered to be, nor construed to be a security interest, collateral, pledge, lien or encumbrance of any kind, nature or description; and all of the rights, titles and interests of VSI in and to such shares shall be and continue to be clear of any and all liens and encumbrances for any and all purposes whatsoever."

The only evidence as to the purpose underlying the use of a gratuitous custodian as provided in paragraph 5(a) is contained in the Goddard affidavit. He states that V.S.I. was not permitted to take possession of the Magnetic Tape stock until it paid the full consideration therefor (Aa15, Aa17). More specifically, he says:

> "To insure the performance of said agreement, all of the shares of stock of GMT were deposited with Harold Israelson, Esq. and were to be delivered to the debtor only upon its having made the final payment of the agreed purchase price as provided by said agreement. None of the installments required by said agreement have been paid."

He states this again in his affidavit at the bottom of page 19a of the appendix:

> "To assure that such payment would be made, the parties expressly agreed that possession of the stock would be given to Harold Israelson, Esq. and would be delivered to the debtor only when all installment payments provided by the modified sale-purchase agreement had been made."

This was repeated a third time at page 20a of Goddard's affidavit:

> "By agreement between the parties, delivery of the shares of stock was not to be made until all installments of the purchase price required by said agreement were paid. Harold Israelson, Esq. was made custodian of the stock until such time as the debtor was entitled to have the shares of stock delivered, so as to assure such delivery and at the same time protect the rights of GPS in the event the purchase price was not paid to it."

Although the reply (and first) affidavit submitted on behalf of V.S.I., by its attorney, went to great lengths to highlight alleged falsehoods (which are denied) of Goddard, it did not contradict in any respect whatsoever the foregoing quotations regarding the intentions of the parties (Aa21 *et seq.*).

After the parties signed this agreement, V.S.I. filed its Chapter XI petition without having made any payments required (Aa15-Aa16). G.P.S. then commenced an action in the Supreme Court of New York against V.S.I. and against Israelson seeking delivery of the Magnetic Tape stock (Aa11-Aa13). V.S.I. did not appear but began the proceedings for a turnover order.

ARGUMENT

POINT I

This proceeding should be remanded to the Bankruptcy Court because the record is unclear if that Court ever considered the issue of whether the adverse claim of G.P.S. was "substantial" or "merely colorable."

A Bankruptcy Court in a Chapter XI proceeding has jurisdiction over property owned by the debtor or in its actual or constructive possession. Bankruptcy Act §311, 11 U.S.C. §711. It may exercise this jurisdiction in a summary manner as to property in the possession of third parties under adverse claims of ownership only if the adverse claimant so consents or if the adverse claim is merely colorable. Where, as here, ownership and possession are contested, the Bankruptcy Court must first determine whether the adverse claim is "substantial" or "merely colorable." As stated in the leading case of *Harrison v. Chamberlin*, 271 U.S. 191 (1926):

> "[T]he Court is not ousted of its jurisdiction by the mere assertion of an adverse claim; but, having the power in the first instance to determine whether it has the jurisdiction to proceed, the court may enter upon a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable. And if found to be merely colorable the court may then proceed to adjudicate the merits summarily; but if found to be real and substantial it must decline to determine the merits and dismiss the summary proceeding." 271 U.S. at 194.

The procedure was reiterated in *Cline v. Kaplan*, 323 U.S. 97 (1944):

> "If the property is not in the court's possession and a third person asserts a *bona fide* claim adverse to the receiver or trustee in bankruptcy, he has the right to have the merits of his claim adjudicated 'in suits of the ordinary character, with the rights and remedies incident thereto.' *Galbraith v. Vallely*, 256 U.S. 46, 50; *Taubel-Scott-Kitzmiller Co. v. Fox*, 264 U.S. 426. But the mere assertion of an adverse claim does not oust a court of bankruptcy of its jurisdiction. *Harrison v. Chamberlin*, 271 U.S. 191, 194. *It has both the power and the duty to examine a claim adverse to the bankrupt's estate to the extent of ascertaining whether the claim is ingenuous and substantial. Louisville Trust Co. v. Cominger*, 184 U.S. 18, 25-26. Once it is established that the claim is not colorable nor frivolous, the claimant has the right to have the merits of his claim passed on in a plenary suit and not summarily. Of such a claim the bankruptcy court cannot retain further jurisdiction unless the claimant consents to its adjudication in the bankruptcy court. *MacDonald v. Plymouth County Trust Co.*, 286 U.S. 263." 323 U.S. at 98-99 (emphasis added).

This Court has also so held on many occasions. In *Slenderella Systems of Berkeley, Inc. v. Pacific Telephone & Telegraph Co.*, 286 F.2d 488 (2d Cir. 1961), affirming a reversal of an exercise of summary jurisdiction, it said:

> "Although the debtor's undisputed title to property not in his possession would be enough under the language of Section 311 to authorize the court to act summarily, the court does not acquire summary jurisdiction if the property does not belong to the debtor and is not in his possession, or if the title to property not in his possession is disputed by a substantial adverse claim. See In re Adolf Gobel, Inc., 2 Cir., 1936, 80 F.2d 849; In re Journal-News Corp., 2 Cir., 1951, 195 F.2d 492.
>
> ° ° °
>
> "Where a substantial issue of law or fact exists as to title, and where the debtor was not in physical pos-

> session of the property on the date of filing his petition, the rights under the contract should not be settled in a summary proceeding. See In re Roman, 2 Cir., 1928, 23 F.2d 556; cf. Matter of Wire Corp. of America, D.C.D.N.J., 1955, 131 F. Supp. 586; In re Meiselman, 2 Cir., 1939, 105 F.2d 995, 997." 286 F.2d at 490.

In accord, Brouner v. Seligson, 416 F.2d 705, 706 (2d Cir. 1969); *In re Bacon*, 210 Fed. 129, 134 (2d Cir. 1913).

The bankruptcy court made no finding of fact that the G.P.S. adverse claim was colorable although required to do so by Bankruptcy Rule 752(a). The District Court excused this failure for the stated reason that such a determination was implicit in the bankruptcy court's finding that the debtor had title to the Magnetic Tape stock (Aa38-Aa39).

This approach is improper because the issues of ownership and of the substantiality of the adverse claim are distinct. The record is unclear whether the bankruptcy judge made the preliminary inquiry into the character of the G.P.S. claim or whether he proceeded directly to the issue of title. The manner in which the bankruptcy judge reached his decision is critical, for the analysis of the adverse claim is mandatory. *Cline v. Kaplan, supra, Louisville Trust Co. v. Cominger*, 184 U.S. 18, 25-26 (1902).

The failure to make a finding of fact as to the substantial or colorable nature of the adverse claim deprives this Court of a full and clear understanding of the basis of the bankruptcy court's reasoning necessary for review. This is underscored by the bankruptcy judge's statement that the agreement construed was "ambiguous" (Aa30). If the agreement was ambiguous, there had to be some question in the judge's mind as to the parties' intentions. Such doubt, coming as it did from the agreement itself,

necessarily indicates that the claim on its face was neither made in bad faith nor without justification. If, as the District Court suggests, the bankruptcy judge implicitly found that the claim was merely colorable, then the bankruptcy court's characterization of the agreement as ambiguous implicitly found that the claim was substantial.

It is difficult, if not impossible, for this or any other reviewing court to know whether this issue was even considered. Under these circumstances the failure to make the requisite finding constitutes reversible error and this Court should remand the case to the bankruptcy court. *Will v. United States*, 389 U.S. 90, 107 (1967), *Mayo v. Lakeland Highlands Canning Co.*, 309 U.S. 310, 316 (1940), *Dopp v. Franklin National Bank*, 461 F.2d 873, 879 n.15 (2d Cir. 1972), *Fuchstadt v. United States*, 434 F.2d 367, 369-370 (2d Cir. 1970), *Securities and Exchange Commission v. Frank*, 388 F.2d 486, 493 (2d Cir. 1968).

For the foregoing reasons, this Court should remand this proceeding to the Bankruptcy Court.

Point II

This proceeding should be remanded to the Bankruptcy Court because the exercise of summary jurisdiction by the Bankruptcy Court was error for the reason that there was substantial doubt as to the debtor's ownership and/or constructive possession of the Magnetic Tape stock.

The criteria by which a bankruptcy court may characterize adverse claims as either "substantial" or as "merely colorable" were stated in *Harrison v. Chamberlin*, *supra*, wherein the Supreme Court stated:

> "[W]e are of the opinion that it (an adverse claim) is to be deemed of a substantial character when the claimant's contention 'discloses a contested matter of

> right, involving some fair doubt and reasonable room for controversy,' . . . in matters either of fact or law; and is not to be held merely colorable unless the preliminary inquiry shows that it is so unsubstantial and obviously insufficient, either in fact or law, as to be plainly without color or merit, and a mere pretense." 271 U.S. at 195.

Recently, in *Cherno v. Engine Air Service, Inc.*, 330 F.2d 191, 193 (2d Cir. 1964) this Court held that a claim was to be deemed merely colorable only if the claim on its face was made in bad faith and without legal justification. The Bankruptcy Court made no such finding. Previously, it had described the factors in such a determination in *In Re Midtown Contracting Co.*, 243 Fed. 56 (2d Cir. 1917) as follows:

> Whether the claim is real or colorable does not depend upon whether it turns upon a question of fact or upon a question of law. Does the claim rest upon mere pretense of fact or of law? Is it put forward in good faith, and in that sense is it real? Or is it put forward in bad faith, and therefore unreal?" 243 Fed. at 63.

In accord, In Re Carburetor Corp., 202 F.2d 75 (2d Cir.) *cert. den.* 345 U.S. 957 (1953).

Characterization of the G.P.S. claim must be based on state law. *In re Bayview Estates, Inc.*, 508 F.2d 405, 407 (6th Cir. 1974), *In re Barasch*, 439 F.2d 1393, 1395 (9th Cir. 1971), *In re Copeland*, 391 F. Supp. 134, 140 (D.Del. 1975), *In re Wright Homes, Inc.*, 279 F. Supp. 598, 601 (M.D.N.C. 1968). The rules of law governing the construction of contracts for the sale of stock are stated in 8 Williston on Contracts §97[illegible] (3d ed. 1974):

> "In contracts of sale of corporate shares, on the other hand, the decisions, in ascertaining when the risks and rights of ownership pass, do not invoke a maxim hoary

> with age and absurd in result. *They seek, as is abundantly clear from a review of the cases, to find the intention of the parties.* Not the immutability of *stare decisis*, but the flexibilty of interpretation, is the watchword here." (emphasis added)

This Court need not concern itself with the issue of choice of law as New York law and New Jersey law are identical on this subject. *Parsons v. Lipe*, 158 Misc. 32, 286 N.Y.S. 60, 84 (Sup. Ct. 1933), *affd. sub nom. Parsons v. First Trust & Deposit Co.*, 243 A.D. 681, 277 N.Y.S. 426 *rearg. den.* 243 A.D. 857, 279 N.Y.S. 287 (4th Dept. 1935) *affd.* 269 N.Y. 630, 200 N.E. 31 (1936); *Martindell v. Fiduciary Counsel, Inc.*, 133 N.J. Eq. 408, 30 A.2d 281, 283 (E & A 1934).

A. *The issue of ownership was a substantial issue which barred the exercise of summary jurisdiction*

The intention of the parties to an ambiguous contract is itself a substantial issue precluding the exercise of summary jurisdiction. As this Court noted in *Spencer, White & Prentis, Inc. of Connecticut v. Pfizer, Inc.*, 498 F.2d 358 (2d Cir. 1974):

> "While the meaning of an unambiguous contract is a question of law, the meaning of an ambiguous one presents a question of fact on which resort may be had to extrinsic aids of construction throwing light upon the intent of the parties. The intent of the parties to an ambiguous contract is a question of fact which cannot be resolved on summary judgment." 498 F.2d at 363-364.

See also, Painton & Co., Ltd. v. Bourns, Inc. 442 F.2d 216, 233 (2d Cir. 1971), *Lemelson v. Ideal Toy Corp.*, 408 F.2d 860, 862-864 (2d Cir. 1969), *Union Insurance So-*

ciety of Canton, Ltd. v. William Gluckin & Co., 353 F.2d 946, 951 (2d Cir. 1965).

If it is error to construe an ambiguous contract on a motion for summary judgment, it is more so error to do so through the exercise of summary jurisdiction. Summary judgment can be granted if there is no genuine issue as to any material fact. Fed. R. Civ. P. 56(c). The existence of a difficult question of law does not preclude the grant of a motion for such relief. *E.g., Ammons v. Franklin Life Ins. Co.*, 348 F.2d 414, 417 (5th Cir. 1965), *Kentucky Rural Electric Co-Op Corp. v. Moloney Electric Corp.*, 282 F.2d 481, 483-484, (6th Cir. 1960) *cert. den.* 365 U.S. 812 *rehg. den.* 365 U.S. 855 (1961).

The existence of such a substantial issue, of law or of fact, does however preclude the invocation of summary jurisdiction. As stated in *Harrison v. Chamberlin, supra*, a claim:

> ". . . is not to be held merely colorable unless the preliminary inquiry shows that it is so unsubstantial and obviously insufficient, either *in fact or law. . . .*" 271 U.S. at 195 (emphasis added).

Similarly, this Court said in *Slenderella Systems of Berkeley, Inc. v. Pacific Telephone & Telegraph Co., supra:*

> "*Where a substantial issue of law or fact exists as to title,* and where the debtor was not in physical possession of the property on the date of filing his petition, the rights under the contract should not be settled in a summary proceeding. See In re Roman, 2 Cir., 1928, 23 F.2d 556; cf. Matter of Wire Corp. of America, D.C.D.N.J., 1955, 131 F. Supp. 586; In re Meiselman, 2 Cir., 1939, 105 F.2d 995, 997." 286 F.2d at 490 (emphasis added).

See also, In Re Midtown Contracting Co., supra:

> "If there is a real question *of law or of fact*, the claimant need not submit it to the court of bankruptcy, unless he consents to do so; but the trustee must institute his independent action in a court having jurisdiction of the subject-matter and have the claim regularly adjudicated, as the bankrupt himself must have done, had bankruptcy proceedings not been pending." 243 Fed. at 63 (emphasis added).

In accord, Matter of Indiana Flooring Co., 62 F.2d 763, 764 (2d Cir.) *cert. den.* 290 U.S. 627 (1943), *In re Marquette*, 254 Fed. 419, 421 (2d Cir. 1918), *In re Kirchoff Frozen Foods, Inc* 375 F. Supp. 156, 161 (D.Ariz. 1972), 2 Collier on Bankruptcy ¶23.07[2](14th ed. 1975).

The District Court held that the bankruptcy judge was permitted to construe the "ambiguous" agreement on the affidavits alone because neither party had sought to introduce oral testimony. (Aa37). That holding was a misapplication of *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970) wherein this Court affirmed the issuance of a preliminary injunction on affidavits alone because the defendant's offer to produce oral testimony fell short of an objection to consideration of the motion on the papers. There the Court was able to resolve the factual issues by reading the papers submitted. In construing the intentions of the parties to this "ambiguous" contract, testimony was not merely desirable as in *Semmes*, but necessary.

Where oral testimony is necessary to resolve a factual controversy, this Court has found reversible error in the failure of a trial court to require such proof. In *Flaks v. Koegel*, 504 F.2d 702 (2d Cir. 1974) this Court reversed the denial of a motion to vacate a default judgment for money damages and remanded for an evidentiary hearing, stating:

"The affidavits submitted by Koegel personally, by his new counsel and by his former counsel created, in our view, material issues of fact which could not have been properly resolved without an evidentiary hearing. As Chief Judge Kaufman indicated in Dopp v. Franklin National Bank, 461 F.2d 873, 879 (2d Cir. 1972), generally a judge should not resolve factual disputes on affidavits or depositions, for then he is merely showing a preference for 'one piece of paper to another. . . .'

"It is true that Koegel had repeatedly failed to respond or to appear, but the papers before the court on the Rule 60(b) motion for the first time, in affidavit form, presented the other side of the story. . . . *The matter could not be determined on the basis of conflicting and competing affidavits. We are in no better or worse position than the district court was in the absence of the evidence which a hearing could produce to determine whether or not Koegel's claims were credible.* This position is not sufficiently secure to support the drastic action taken." 504 F.2d at 712-713 (emphasis added).

In *Dopp v. Franklin National Bank*, 461 F.2d 873 (2d Cir. 1972), cited in the above quotation, this Court stated:

"*Generally, of course, a judge should not resolve a factual dispute on affidavits or depositions, for then he is merely showing a preference for 'one piece of paper to another.'* Sims v. Greene, 161 F.2d 87, 88 (3d Cir. 1947). *This is particularly so when the judge, without holding an evidentiary hearing, resolves the bitterly disputed facts in favor of the party who has the burden of establishing his right* to preliminary relief.* *See id.*; 7 Moore, Federal Practice §65.04[3]. This caveat is most compelling 'where every thing turns on what happened and that is in sharp dispute; in such instances, the inappropriateness of proceeding on affi-

* V.S.I. had the burden of persuasion on its application for a turnover order. 2 Collier on Bankruptcy ¶23.10[2] (14th ed. 1975).

davits attains its maximum. . . .' Securities and Exchange Commission v. Frank, 388 F.2d 486, 491 (2d Cir. 1968) (Friendly, C.J.). In this case, where all stands or falls on Dopp's claim, denied by Sutherland, that an oral agreement was made in August giving him a right of first refusal, an evidentiary hearing was essential to resolve the credibility gap.

"Dopp maintains, however, that Franklin waived its right to a hearing because it did not insist on one. It is true that we have held that a defendant who joins 'the battle of affidavits with as much relish as the [plaintiff]' should not be heard to complain when the decision is adverse. Semmes Motors, Inc. v. Ford Motor Co. 429 F.2d 1197, 1205 (2d Cir. 1970). We reaffirm that principle here, but *even where a party can be deemed to have waived his right to a hearing, the movant is not relieved of his burden of establishing a reliable factual basis for the preliminary injunction.* 7 Moore, Federal Practice, ¶65.04[3], at 1641. *Certainly, it could not be suggested that the parties could waive their right to a decision according to law and confer upon the district judge the power to decide by a toss of the coin.*" 461 F.2d at 879 (emphasis added).

The Goddard affidavit repeatedly stressed that V.S.I. would not be entitled to possession of the Magnetic Tape stock unless and until all payments were made in accordance with paragraph 4(a) of the agreement. The agreement recites that those payments constituted conditions precedent to its effectiveness, *i.e.*, until V.S.I. satisfied all its obligation, it could not receive the stock certificates. G.P.S., according to the agreement, did not have a security interest in the stock. None of this was contradicted by the affidavit of the debtor's attorney. Yet the bankruptcy judge was able to state that the intent of the parties was otherwise (Aa30-Aa31).

Moreover, while the bankruptcy judge was not able to construe the agreement as intending to divest V.S.I. of

title, V.S.I. had no title of which to be divested because the original March 1972 agreement by which it had initially purchased the stock was rescinded by operation of law by the parties' institution of separate lawsuits each of which sought to recover what had passed from the respective plaintiffs. This legal rescission is discussed in greater detail in Point III, *infra*.

Both the Bankruptcy Court and the District Court were impressed by V.S.I.'s continued operation of Magnetic Tape, but this is not inconsistent because V.S.I. had an equitable interest in the stock and there would have been no sense in G.P.S.' operation of the company when V.S.I. had the stronger interest in it. Both lower courts were also impressed by the statement in Fischman's affidavit that "GMT constitutes a vital and substantial asset of the debtor necessary to the operation of the debtor." This is immaterial to the issue of title.

In the light of all these facts, the Bankruptcy Court could not have construed the agreement without the assistance of oral testimony. The agreement, which the Bankruptcy Judge termed "ambiguous" on his own initiative, is nothing less than an abomination of draftsmanship. It says whatever the reader wants it to say. Under these circumstances there has to be substantial doubt as to the parties' intentions. Under these circumstances, it cannot be said that this claim was made in bad faith and without legal justification. Therefore, the invocation of summary jurisdiction was improper and should be reversed.

B. *The issue of constructive possession was a substantial issue which barred the exercise of summary jurisdiction*

The Bankruptcy Court also found that the debtor had constructive possession of the Magnetic Tape stock. In ruling on this ground, it said:

> "The question of constructive possession is less clear." (Aa31)
>
> "In any event, even though jurisdiction based on constructive possession be said to be doubtful because of the ambiguous position of the debtor as bailor, . . ." (Aa32)

Thus the finding of constructive possession was admittedly one as to which the bankruptcy judge had substantial doubt. For this reason alone, the exercise of summary jurisdiction based on this ground is reversible error.

Moreover, the very reasoning of the bankruptcy judge employed to find constructive possession does not support that conclusion. For example, he relied heavily on the test of constructive possession stated by this Court in *Buss v. Long Island Storage Warehouse Co.*, 64 F.2d 338 (2d Cir. 1933). The relevant language thereof states:

> "The power over a bankrupt's estate depends primarily on actual custody, . . . However, its power is not limited to goods of which it has actual custody. . . . It may also seize summarily other goods, which are in that case said to be 'constructively' in its possession at petition filed. *The underlying condition upon this incidental power is that the property must be in the possession of one who acknowledges that he holds it subject to the bankrupt's demand.* Such a bailee, making no claim of interest, is subject to the orders of the bankruptcy court as such." 64 F.2d at 339 (emphasis added).

Application of this rule to the instant case, however, does not support a holding of constructive possession by V.S.I. Firstly, the custodian, Israelson, never acknowledged, nor does the argreement specify, that he held the Magnetic stock subject to V.S.I.'s demand. Indeed, Israelson could not so acknowledge because he held the

stock subject only to the agreement which created his title and role. V.S.I. had no right under the agreement to demand possession of the stock prior to the effective date of the agreement, after payment of all money due G.P.S. under paragraph 4.

A similar situation is reported in *In Re American Southern Publishing Co.*, 426 F.2d 160, 163-164 (5th Cir.) *cert. den. sub nom. Bailes v. First National Bank of Mobile*, 400 U.S. 903 (1970). There the Referee's holding of jurisdiction based upon the bankrupt's constructive possession of the assets in question was reversed because the bailee in actual possession could not surrender those assets to the debtor-bailor without the approval of the adverse claimant. Israelson's position is identical.

Likewise, in *Bayview Estates, Inc. v. Bayview Estates Mobile Homeowners' Association, supra, affg.* CCH Bankruptcy L. Reptr. ¶65,345 (E.D. Mich. 1974), the Sixth Circuit affirmed the district court's reversal of a finding of constructive possession by a debtor-landlord of rentals deposited in escrow by tenants. The holding by the appellate courts there that the debtor-landlord did not have constructive possession of those funds was premised on the escrowee's right under state law to return the rentals held to the tenants. That reasoning should also control this case since Israelson would have been obliged to return the Magnetic Tape stock to G.P.S. if the debtor did not satisfy the conditions precedent.

The Bankruptcy Court was also influenced improperly by *Matter of Goldman*, 5 F. Supp. 973 (S.D.N.Y. 1933). There the asset in dispute had been deposited with a third person "for the bankrupt's benefit." The adverse claim of ownership was not asserted until after the bankrupt had filed its petition in bankruptcy. That is not so in this case. The stock had been delivered to

Israelson for the protection of both buyer and seller and V.S.I.'s adverse claim had been advanced no later than in the agreement itself.

The Bankruptcy Court also erred in comparing the term "gratuitous custodian" as used in the agreement with the term "gratuitous bailee." A bailee holds for the benefit of the bailor. A custodian does not necessarily hold possession for the benefit of any one particular person. A custodian is concerned only with the keeping, guarding, care, watch, inspection and preservation of the thing. *Southern Carbon Co. v. State*, 171 Misc. 566, 13 N.Y.S.2d 7, 9 (Ct. Cl. 1939) *affd.* 258 A.D. 1004, 16 N.Y.S.2d 719 (3d Dept. 1940). This equation of terms required the bankruptcy judge to concern himself with whether Israelson took custody of the Magnetic Tape stock for the benefit of V.S.I. or for the benefit of G.P.S. No such election was required; as custodian, Israelson held the stock for the benefit of both in accordance with the agreement, the terms of which governed his rights and duties.

For these additional reasons, this Court should rule that the finding of constructive possession by the Bankruptcy Court was in error and not a basis for summary jurisdiction. The District Court did not discuss this issue in its opinion.

Point III

Assuming, *arguendo*, the absence of such doubt as to require a plenary trial, V.S.I. had no title to the Magnetic Tape stock.

In March 1972 G.P.S. entered an agreement to sell its interest in Magnetic Tape to V.S.I. Under this agreement V.S.I. was to pay for the stock over a period of time, the amount of payments contingent upon the profitability of

Magnetic Tape. When V.S.I. failed to make payments required, G.P.S. instituted litigation in the Superior Court of New Jersey seeking, *inter alia*, rescission of the agreement. Thereafter V.S.I. instituted a second lawsuit seeking return of the money it had previously paid for the Magnetic Tape stock. The filing of this second complaint accomplished, by operation of law a *legal* rescission of the March 1972 agreement. Title to the stock revested automatically, by operation of law, in G.P.S.

The filing of V.S.I.'s lawsuit for return of the money it had previously paid for Magnetic Tape manifested its assent to the rescission previously sought by G.P.S. in the New Jersey litigation. Although V.S.I. never said in so many words, "We have now effectuated a legal rescission," that was the proper inference drawn from its actions. A rescission need not be express, but may be implied by a party's actions. 15 Williston on Contracts §1826 (3rd ed. 1974), 5A Corbin on Contracts §1236 (1971), Restatement, Contracts §406, Comment (b) (1932), *Armour & Co. v. Celic*, 294 F.2d 432, 435-436 (2d Cir. 1961), *Invengineering, Inc. v. Foregger Co., Inc.*, 293 F.2d 201, 203 (3d Cir. 1961) (applying New York law), *In Re Schanzer's Estate*, 7 A.D.2d 275, 182 N.Y.S.2d 475, 479 (1st Dept. 1959) *affd* 8 N.Y.2d 972, 204 N.Y.S.2d 349, 169 N.E. 2d 11 (1960), *Schwartzreich v. Bauman-Basch, Inc.*, 105 Misc. 214, 172 N.Y.S. 683, 685 (App. T.1st Dept. 1918) *affd* 188 A.D. 960, 176 N.Y.S. 921 (1st Dept. 1919) *affd* 231 N.Y. 196, 131 N.E. 887 *rearg den.* 231 N.Y. 602, 132 N.E. 905 (1921), *Mossberg v. Standard Oil Co. of New Jersey*, 98 N.J. Super. 393, 406-407, 237 A.2d 508, 515-516 (Law Div. 1967), *Skillman Hardware Co. v. Davis*, 53 N.J.L. 144, 149, 20 A. 1080, 1082 (Sup. Ct. 1890).

This Court has held that similar actions have constituted legal rescissions of agreements to arbitrate. Thus,

in *Nortuna Shipping Co. v. Isbrandtsen Co., Inc.*, 231 F.2d 528 (2d Cir.) *cert den.* 351 U.S. 964 (1956), Judge Medina stated:

> "That the right to compel arbitration under the Federal Arbitration Act may be waived is clearly established. . . . In these cases, however, the party held to have waived its right to arbitrate a dispute either had commenced suit in court . . . or, if named as defendant in an action brought against him, had stipulated for some other mode of settlement, William S. Gray & Co. v. Western Borax Co., 9 Cir., 99 F.2d 239, or had answered on the merits or had set up a counterclaim, Radiator Specialty Co. v. Cannon Mills, Inc., 4 Cir., 97 F.2d 318. *The principle involved is that invoking or actively assenting to the jurisdiction of a court, being manifestly inconsistent with an assertion of the right to arbitrate the same dispute, constitutes a waiver.*" 231 F.2d at 529 (emphasis added).

Another leading New York case for this proposition is *Matter of Zimmerman v. Cohen*, 236 N.Y. 15, 139 N.E. 764 (1923) wherein Judge Crane stated:

> "The facts in this case show that the parties elected to settle their disputes not by arbitration but in a court of law. The arbitration provision of the contract was abandoned or waived. The plaintiffs made this election when they brought their action against the defendant ignoring the agreement to arbitrate. *The defendant made his election when he answered, setting up a counterclaim* upon which he asked the court to give judgment against the plaintiffs, gave notice of trial and procured an order for the taking of a deposition in preparation for trial. *These acts were clearly inconsistent with the defendant's later claim that the parties were obligated to settle their differences by arbitration.*" 236 N.Y. at 19, 139 N.E. at 765 (emphasis added).

This is also the law in New Jersey if the law of that state applies. In *McKeeby v. Arthur*, 7 N.J. 174, 81 A.2d 1 (1951) the Supreme Court of that State held:

> *"[W]e are of the opinion that the bringing of action by both parties on the subject matter of the agreement manifests a mutual change of mind and does accomplish a revocation.* When all parties to an agreement to arbitrate elect to prosecute their respective claims by actions at law, and institute and carry forward the course thus elected, the logical, indeed the necessary, result of that course is an abandonment of arbitration and a revocation of the agreement to pursue that form of adjudication." 7 N.J. at 182, 81 A.2d at 5 (emphasis added).

See also, Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 989 (2d Cir. 1942), *The Belize*, 25 F.Supp. 663, 664 (S.D.N.Y. 1938) *app. dis.* 101 F.2d 1005 (2d Cir. 1939), *Cargo Carriers, Inc. v. Erie & St. Lawrence Corp.*, 105 F.Supp. 638, 639 (W.D.N.Y. 1952).

Applied to the facts of this case, this principle means that the 1972 contract by which G.P.S. agreed to sell its Magnetic Tape stock to V.S.I. was rescinded by the mutual agreement of the parties. Certainly, when a seller of an item sues for its return and the buyer seeks return of the money paid, the entire purpose of the contract is destroyed. Because the subsequent 1973 settlement agreement never became effective, G.P.S. held title as it had prior to the first agreement of the parties.

Recognition of this rescission makes the later 1973 agreement more meaningful. It explains many of the ambiguities, including the absence of a provision vesting title to the Magnetic Tape stock in G.P.S. and of a provision regarding the custodian's duties if V.S.I. failed to make the payments conditional upon the agreement's effec-

tiveness. Such provisions were unnecessary. Since G.P.S. owned the Magnetic Tape stock by virtue of the rescission of the prior, first, agreement, it already had title and could always demand the return of its own stock from the custodian if the agreement did not become effective by the satisfaction of the conditions precedent. This construction is more sensible and logical than that which the arrangement court was forced to make by reason of its holding that V.S.I. had title. The mere fact, not in evidence, that V.S.I. may have been the record owner of the Magnetic Tape stock is immaterial. Title was in G.P.S. by operation of law, and equity, which compels to be done that which ought to be done, would have directed the correction of the stock books if necessary. *Travis v. Knox Terpezone Co.*, 215 N.Y. 259, 263, 109 N.E. 250, 251 (1915).

The District Court did not accept this argument because it believed that G.P.S. had never raised its adverse claim of ownership in the bankruptcy court (Aa38). This is error. Such claim was made by Goddard responding to the order to show cause. At numerous times throughout his affidavit he insists that V.S.I. was not entitled to possession of the Magnetic Tape stock and that Israelson was to hold it until G.P.S. had been paid. While the claim of ownership perhaps could have been made with more directness, Goddard's lay equation of possession and ownership is evident.

The District Court also did not accept this argument because it believed that G.P.S.' retention of some money which had been paid by V.S.I. prior to the first action for rescission defeated its claim to title. This is error for several reasons. For one reason, it would have been senseless for G.P.S. to have returned this money. Moreover, the subsequent settlement agreement gave G.P.S. the right to keep that money. In addition, the tender of pay-

ment was implicit in G.P.S.' complaint seeking rescission and did not have to be specially pleaded under N.J. Court Rule 4:5-8, similar to Fed. R. Civ. P. 9. *Cf., Morris v. Prefabrication Engineering Co.*, 160 F.2d 779, 781-782 (5th Cir. 1947). Fourthly, restitution of moneys paid under a contract does not always follow upon rescission thereof. *See*, Restatement, Contracts §409, Comment (a) which says:

> "There is no rule of law establishing a presumption that restitution shall be made or shall not be made when an earlier contract is rescinded. The question is to be determined on the facts of each case."

See also, 15 Williston on Contracts §1827 (3d ed. 1974).

In reading this affidavit, the Court must not lose sight of the fact that Goddard was not responding to any evidence. His affidavit was the first piece of evidence introduced, the order to show cause having issued on an unattested application of Friedmann, Fischman & Chikofsky, the debtor's attorneys, in violation of Fed. R. Civ. P. 43(d) that a motion based on facts not in the record be supported by affidavit. See, for example, 60 C.J.S., "Motions and Orders §20(c) (1974) which provides:

> "A rule or order to show cause should be supported by affidavit. All the facts required by statute or rules of practice should be set forth in the affidavit, and a motion based on an affidavit insufficient in these respects may not properly be granted."

See also, Fed. R. Evid. 603 which provides:

> "Before testifying, every witness shall be required to declare that he will testify truthfully by oath or affirmation adminstered in a form calculated to awaken his conscience and impress his mind with his duty to do so."

This requirement of an oath is a requisite for all testimony to be used in court. *United States v. Fiore*, 443 F.2d 112, 115 (2d Cir. 1971). It applies also to affidavits. *People v. Jonas*, 35 A.D.2d 615, 312 N.Y.S.2d 569, 572 (3d Dept. 1970).

To strictly construe Goddard's affidavit, then, is unfair because he was simply responding to unattested charges made by the debtor's attorneys. This is particularly unfair when coupled with the impropriety of the debtor's attorneys testifying for their client. *Cf.*, *Royal Indemnity Co. v. Westinghouse Electric Corp.*, 385 F.Supp. 520 (S.D.N.Y. 1974) wherein Judge Weinfeld stated:

> "The salutary purpose of Rule 56 and its requirement that 'affidavits shall be made on personal knowledge, [and] shall set forth such facts as would be admissible in evidence,' cannot be aborted by conjectures of plaintiff's attorney, who is without personal knowledge of the facts and is an incompetent witness on the subject. (Footnote citations to Union Ins. Soc. v. William Glucken & Co., 353 F.2d 946, 952 (2d Cir. 1965); Sylvester v. Morgan, 125 F. Supp. 380, 389-390 (S.D. N.Y. 1954) affd 220 F.2d 758 (2d Cir. 1955)." 385 F. Supp. at 523.

Both the Bankruptcy Court (Aa31) and the District Court (Aa40) apparently believed that V.S.I.'s continued operation of Magnetic Tape was evidence of its ownership. This suggests that the Bankruptcy Court believed G.P.S. had raised an adverse claim of ownership for this statement otherwise would have been completely unnecessary.

In any event, this continued operation is irrelevant and immaterial. It does not indicate any acquiescence therein by G.P.S. because three months after V.S.I.'s breach of the agreement, G.P.S. instituted litigation in the Supreme Court of New York to regain control. Prior thereto, G.P.S.

by agreement had allowed V.S.I. to retain operating control of Magnetic Tape after the execution of the settlement agreement; at that time, V.S.I. had an equitable interest in the Magnetic Tape stock, the parties did not enter the agreement expecting its breach, and frequent changes of management could not be helpful to company operations.

For the foregoing reasons, the 1973 agreement never became effective and the 1972 agreement was rescinded by the parties, and G.P.S. owns the Magnetic Tape stock.

POINT IV

The bankruptcy proceedings were void *ab initio* because no complaint has ever been filed and because the order to show cause was improperly issued.

A. *No complaint was filed*

Bankruptcy Rule 703 requires that adversary proceedings to recover property be commenced by filing a complaint with the Court. No complaint has been filed, although an application for a turnover order is a proceeding within the rule. *See*, Bankruptcy Rule 701(1) and 2 Collier on Bankruptcy ¶23.10[3] (14th ed. 1975) which provides:

> "Where a turnover order is sought, a written complaint . . . should be filed."

Neither a notice of motion nor an order to show cause is a complaint. *Cf., Bigelow v. RKO Radio Pictures,* 16 F.R.D. 15, 17 (N.D. Ill. 1954).

B. *Process was improperly issued*

The order to show cause was issued as process in this action. This was improper because the debtor's appli-

cation was not supported by admissible evidence inasmuch as the statement of Friedmann, Fischman & Chikofsky was not made on personal knowledge and was made on neither oath nor affirmation. One cannot cross-examine a law firm. 60 C.J.S., "Motions and Orders," *supra*. *See also*, Fed. R. Civ. P. 43(e).

C. *Process was improperly served*

Bankruptcy Rule 704 permits service of the summons and complaint in accordance with Fed. R. Civ. P. 4(d) or by mail. In either event, the summons and complaint shall be served together. *Phillips v. Murchison*, 194 F.Supp. 620, 622 (S.D.N.Y. 1961). Since there was no complaint, service could not be effected in accordance with these rules.

The arguments advanced under this Point IV relating to the debtor's failure to file a complaint and relating to insufficiency of process and of the service of process were not raised below. G.P.S. recognizes that appellate courts ordinarily do not consider points not raised below. This rule, however, is not absolute. *E.g., Green v. Brown*, 398 F.2d 1006, 1009 (2d Cir. 1968). Because these arguments attack the foundation of this proceeding, *i.e.*, the Bankruptcy Court's jurisdiction and the scope of the issue, G.P.S. urges this Court to reverse and to dismiss this proceeding for this reason also.

CONCLUSION

For the reasons stated herein, G.P.S. urges that this Court reverse and remand for a plenary hearing. If the Court decides, however, that the facts are sufficiently clear as to warrant summary disposition, then G.P.S. urges the Court to reverse the judgment below and to award title of Magnetic Tape to G.P.S.

Respectfully submitted,

MILLER and BUSH
and
ROBERT ALAN VORT
Attorneys for Appellant

By: /s/ Robert Alan Vort
ROBERT ALAN VORT

APPENDIX

Order to Show Cause for Turnover

Upon the annexed application of VISUAL SOUNDS, INC., debtor-in-possession, by its attorneys Friedmann, Fischman & Chikofsky dated August 12, 1974, and it clearly appearing from said application that in the event the property therein described is removed, transferred or sold, it will result in injury or damage to the applicant and this estate to the extent of the additional expenses incurred in recovering said property, and the said damages will be irreparable for the reason that such additional expenses may not be recovered by applicant or this estate, and that such irreparable damage or injury will result to applicant before notice can be served and a hearing had on an application for such temporary restraining order that an order should be issued temporarily restraining said Harold G. Israelson, Esq. or General Packaging Services, Inc. from removing, transferring or conveying said property and no adverse interest being represented.

LET Harold G. Israelson, Esq. and General Packaging Services, Inc. show cause before the undersigned Bankruptcy Judge at Room 201 at the United States Courthouse, Foley Square, New York on the 21st day of August, 1974 at 8:30 o'clock in the forenoon why they should not be required to turn over and surrender to the debtor-in-possession 140 shares of the common stock and 250,000 shares of 6% non-cumulative preferred stock of the General Magnetic Tape Co., Inc. in their possession, and why the debtor should not be granted such other and further relief as is just.

Sufficient reason appearing therefor, let service of a copy of this order and application on Harold G. Israelson, Esq. and Irving T. Bush, Esq. attorneys for General Packag-

ing Services, Inc., on or before August 13, 1974 be deemed good and sufficient service.

IN THE MEANTIME, and for a period of ten days from the date hereof, unless otherwise ordered by this court, Harold G. Israelson, Esq. and General Packaging Services, Inc., their officers, agents, servants, employees and attorneys are hereby forbidden and enjoined from in any manner conveying, transferring, assigning or encumbering any of the above described property or continuing any lawsuit with respect to said property.

/s/
Bankruptcy Judge

Issued August 13, 1974
at 12:50 P.M.

/s/ Roy Babitt
Bankruptcy Judge

Application

VISUAL SOUNDS, INC. by its attorneys Friedmann, Fischman & Chikofsky, respectfully shows:

1. The debtor filed a petition for an arrangement on or about April 8, 1974 and was continued in possession of its property by order of this court of even date.

2. That the major asset of the debtor is the ownership and operation of a wholly owned subsidiary General Magnetic Tape, Inc., a New Jersey corporation.

3. That the shares of said corporation were purchased from General Packaging Services, Inc., a New Jersey corporation.

4. That as a consequence of that purchase, a multiplicity of lawsuits were begun between the purchasers and sellers involved, which lawsuits were finally resolved on or about October 2, 1973. A copy of the settlement agreement and releases is attached hereto and made a part hereof.

5. That pursuant to paragraph "5," page "4' of said settlement agreement, all of the issued and outstanding stock of General Magnetic Tape Co., Inc., were delivered to Harold G. Israelson, Esq., who acted as a "gratuitous custodian of said stock certificates." Further, the said custodian account was not to be considered "as a security interest, collateral, pledge, lien or encumbrance."

6. That heretofore and on or about July 17, 1974 an action was instituted in the Supreme Court, State of New York, County of New York on behalf of General Packaging Services, Inc. against the debtor. Copy of the alleged summons and complaint is attached hereto and made a part hereof.

7. Thereafter and on or about July 29, 1974 General Packaging Services, Inc. was served with the order restraining actions issued in this proceeding, by having a copy of same mailed to his attorneys.

8. Thereafter on August 12, 1974 the letter of August 9, 1974 from the attorneys representing General Packaging Services, Inc., Miller and Bush, was received, wherein said attorneys express the opinion that they will proceed with the above described lawsuit. A copy of said letter is attached hereto and made a part hereof.

9. That the stock at issue constitutes a vital and substantial asset of the debtor and there is no basis for its continued possession by Harold G. Israelson and that the lawsuit to recover said property is clearly contrary to the express meaning and interest of the Bankruptcy Act in this proceeding.

WHEREFORE, applicant prays for the annexed order, for which no previous application has been made.

VISUAL SOUNDS, INC.
By Friedmann, Fischman &
Chikofsky, its attorneys

Dated: New York, New York
August 12, 1974

Settlement Agreement and Releases

WHEREAS, on or about the 1st day of March 1971, VISUAL SOUNDS, INC., a Delaware corporation (hereinafter referred to as "VSI"), had entered into an agreement whereby GENERAL PACKAGING SERVICES, INC., a New Jersey corporation (hereinafter referred to as "GPS"), sold to VSI all of the issued and outstanding shares of GENERAL MAGNETIC TAPE CO., INC., a New Jersey corporation (hereinafter referred to as "GMT"); and

WHEREAS, certain differences and problems have arisen between and among VSI, GPS, GMT and individual officers, agents and servants of the aforesaid companies, namely, JOHN T. GORDY, JR. (hereinafter referred to as "GORDY"); FREDERICK N. KINNE (hereinafter referred to as "KINNE") ;and EDWIN M. GODDARD (hereinafter referred to as "GODDARD"); and

WHEREAS, several lawsuits have been instituted in the courts of New York, New Jersey and in the Federal District Court among all of the aforesaid corporations and individuals; and

WHEREAS, all of the aforesaid parties and their respective attorneys have negotiated a settlement of all of the differences among them and have agreed to resolve their respective differences by this Settlement Agreement upon all of the terms, covenants and conditions set forth,

NOW, THEREFORE, for and consideration of the sum of One Dollar ($1.00) herein paid by each of the parties to this Settlement Agreement, and all of the covenants, terms and conditions hereinafter set forth, it is mutually agreed and undertaken by the parties hereto as follows:

1. VSI, GPS, GMT, each for itself and respectively its predecessors, survivors and assigns, and anyone claiming

through or under each of it or them, hereby and by these presents remise, release and forever discharge each other and the individual signatories to this Settlement Agreement and their respective subsidiary companies, and its and their respective predecessors, successors and assigns, and all of their past, present and future officers, directors, agents, servants and employees and their respective successors, assigns, heirs, executors and administrators thereof, and/or each of the aforesaid, from all claims, actions, causes of actions, administrative proceedings and claims of every kind, nature and description from any period of time prior to the date of these presents until the date of these presents.

2. GORDY, KINNE and GODDARD hereby and by these presents, their predecessors, successors, heirs, executors and assigns, and anyone claiming through or under each of them, do hereby, each for themselves, remise, release and forever discharge each other and also VSI, GPS and GMT and their subsidiary companies and their respective predecessors, successors and assigns, and all of their respective past, present and future officers, directors, agents, servants and employees and their respective successors, assigns, heirs, executors and administrators thereof, and/or each of the aforesaid, from all claims, actions, causes of actions, administrative proceedings, and claims of every kind, nature and description from any period of time prior to the date of these presents until the date of these presents.

3. All of the parties hereto undertake and agree to execute any and all necessary and required releases, waivers and documents to dismiss with prejudice any and all claims now pending in the courts of the States of New York, New Jersey and the Federal District Court, and each party will be required to file such dismissal docu-

ments without notice to any of the other parties and without costs to any of the other parties therefor.

4. It is a condition precedent to the effectiveness of this Settlement Agreement and Releases that:

(a) VSI agrees and guarantees to pay its promissory note payable to GPS in the principal amount of Fifty Thousand Dollars ($50,000) which is now held by the Marine Midland Bank of New York and which is due on the 1st day of April, 1974. VSI undertakes and agrees that it will take the necessary steps to keep KINNE and GODDARD harmless from their respective guarantees or obligations to the said Fifty Thousand Dollars ($50,000) promissory note.

(b) The sum of One Hundred Thousand Dollars ($100,000) which had previously been paid to GPS by VSI shall continue to belong to GPS without any claims or demand thereon from VSI.

(c) KINNE and GODDARD undertake and agree to return all stock certificates, stock rights, stock powers, warrants, options and without limiting the generality of the foregoing, any other types of securities or equities which they now have or may hereafter be entitled to receive from VSI, and shall return the same with appropriate and proper legal documentation to re-assign any and all thereof to VSI.

(d) VSI agrees to pay the sum of Twenty-Five Thousand Dollars ($25,000) to GPS, and such payment will be made at the rate of One Thousand Dollars ($1,000) per month starting on the 15th day of May, 1974 and continuing thereafter on the 15th day of each month consecutively thereafter for twelve (12) months and the balance then unpaid will be paid on the 15th day of the thirteenth month. Such payments shall be evidenced by negotiable

promissory notes with the usual grace period and an acceleration clause.

5. (a) All of the issued and outstanding stock of GMT shall be delivered to Harold G. Israelson, Esq., of Israelson & Streit, 521 Fifth Avenue, New York, New York; and the said Harold G. Israelson, Esq. will act merely as a gratuitous custodian of such stock certificates of GMT and not as an escrow agent, nor as a pledgeholder, nor as a guarantor, nor in any other manner or capacity, but solely as custodian of those stock certificates. The said certificates shall be returned promptly to VSI upon payment of the Twenty-Five Thousand Dollars ($25,000) referred to in paragraph 4(d) above. The said custodian account shall not be, nor considered to be, nor construed to be a security interest, collateral, pledge, lien or encumbrance of any kind, nature or description; and all of the rights, titles and interests of VSI in and to such shares shall be and continue to be clear of any and all liens and encumbrances for any and all purposes whatsoever.

(b) Notwithstanding the provisions of subparagraph (a) above, VSI and GORDY acknowledge that KINNE, GODDARD and GPS, either individually or collectively, had issued their joint and/or personal guarantees to certain creditors and/or trade suppliers of VSI and/or GMT during the incumbence of KINNE as an officer of VSI. VSI agrees to hold KINNE, GODDARD and GPS harmless with respect to any claim in connection with such guarantees. If such guarantees are not removed or terminated on or before the last payment as provided for in paragraph 4(d) above, then the custodian account as described in subparagraph (a) above shall continue until such guarantees are removed or terminated; but in no event, however, may such extension of the custodian account continue beyond the period of six (6) months after the final payment as hereinabove referred to.

6. It is of the essence of this agreement, and the parties hereto fully recognize the importance thereof, that this Settlement Agreement and Releases will completely terminate any and all relationships and business understandings and agreements heretofore had, alleged, claimed or averred by any of the parties hereto with any of the others and that this Settlement Agreement and Releases fully, completely and finally terminates, ceases and abrogates any understandings, agreements, instruments, documents or pacts among any of the parties hereto, whether the same be oral or written, express or implied.

IN WITNESS WHEREOF, the parties hereunto have set their hands and seals this 2nd day of October, 1973.

VISUAL SOUNDS, INC.
By: /s/ John Gordy, Jr.
Title—President

GENERAL PACKAGING SERVICES, INC.
By: /s/ Frederick N. Kinne
Title—President

GENERAL MAGNETIC TAPE CO., INC.
By: /s/ John Gordy, Jr.
Title—C.O.B.

/s/ John T. Gordy, Jr.
JOHN T. GORDY, JR.

/s/ Frederick N. Kinne
FREDERICK N. KINNE

/s/ Edwin M.Goddard
EDWARD M. GODDARD

Summons

To the above named Defendant

YOU ARE HEREBY SUMMONED to answer the complaint in this action and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the Plaintiff's Attorney(s) within 20 days after the service of this summons, exclusive of the day of service (or within 30 days after the service is complete if this summons is not personally delivered to you within the State of New York); and in case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Dated, July 12, 1974.

MILLER & BUSH
Attorney(s) for Plaintiff
Office and Post Office Address
405 Lexington Avenue
NYC, NY 10017

Complaint

Plaintiffs by Miller & Bush, their attorneys, for their complaint allege:

1. Plaintiff General Packaging Services, Inc. (herein called GPS) is a New Jersey Corporation, with its principal offices at 168 Hopper Avenue, Waldwick, New Jersey.

2. Upon information and belief defendant Visual Sounds, Inc. (herein called VSI) is a Delaware Corporation with its principal office at 3 West 57th Street, New York City, New York, and authorized to do business in New York State.

3. That heretofore and on or about March 1, 1972 plaintiffs and defendant VSI did enter into an oral agreement pursuant to which said defendant did agree to purchase from plaintiffs all of the issued and outstanding stock of a New Jersey corporation known as General Magnetic Tape, Inc. (herein called GMT).

4. That pursuant to said agreement of March 1, 1972, the common stock of GMT was delivered to defendant VSI.

5. Thereafter and on or about April 1973, the plaintiffs GPS and Frederick N. Kinne did commence an action in Superior Court of New Jersey, Law Division, Bergen County, in which it was claimed that the Defendant VSI had breached said agreement of March 1, 1972 and did request, among other things, that the GMT stock be returned to said plaintiffs.

6. That on or about October 2, 1973, said plaintiffs, GPS and Frederick N. Kinne, also plaintiffs in said action commenced in Superior Court of New Jersey, and plaintiff Edward M. Goddard, and defendant VSI, did enter into an

agreement settling said action commenced in the Superior Court of New Jersey pursuant to which defendant did agree to pay to plaintiffs for said stock of GMT $50,000 which was in the form of a note previously issued by defendant pursuant to the agreement of March 1, 1972, and which was due April 1, 1974, and an additional sum of $25,000 in a series of 12 payments of $1,000 each to start on May 15, 1974, and on the 15th day of each month consecutively thereafter, for twelve months, and a final payment of the balance on the 15th day of the thirteenth month; such payments were to be evidenced by negotiable promissory notes with an acceleration clause.

7. That the said parties did further agree, that pending the payment of said sums of money, all of the stock of GMT would be held by defendant Harold G. Israelson of Israelson and Street, Esqs., 521 Fifth Avenue, New York City, New York, and if the moneys were not paid, said stock of GMT would be delivered to plaintiffs.

8. That defendant VSI has breached said agreement of October 2, 1973 in that it has failed to pay the note of $50,000 due April 1, 1974, or any of the installments of the additional sum of $25,000, which by reason of the acceleration provision is now all due.

9. That defendant Harold G. Israelson, Esq. still holds all of the issued and outstanding stock of GMT.

10. That plaintiffs have no adequate remedy at law.

WHEREFORE, plaintiffs demand that this Court declare that defendant Visual Sounds, Inc. has breached said agreement of October 2, 1973, and direct that defendant, Harold G. Israelson, turn over to plaintiffs all of the shares of stock of General Magnetic Tape, Inc., which he is now

holding, together with the costs and disbursements of this action.

Dated: July 12, 1974
New York City, New York

MILLER & BUSH, ESQS.
Attorneys for Plaintiffs
405 Lexington Avenue
New York City, N.Y. 10017

Letter dated August 9, 1974

Friedmann, Fischman & Chikofsky, Esqs.
3 West 57th Street
New York City, New York 10019

Re: General Packaging Services, et al.
v. Visual Sounds, Inc., et al.

Dear Sirs:

We are in receipt of your letter of July 29, 1974 pertaining to the above-captioned matter, together with a copy of the Order of the Bankruptcy Court submitted therewith.

It is our opinion that the Order of the Bankruptcy Court expressly excludes the action here involved. It is our intention to proceed to obtain a default judgment in the event that we do not receive your answer on or before August 14, 1974.

Very truly yours,

MILLER & BUSH

/s/ Irving T. Bush
IRVING T. BUSH

ITB/bw

Affidavit of Edwin Goddard

STATE OF NEW YORK)
)
COUNTY OF NEW YORK)

EDWIN GODDARD being duly sworn deposes and says:

That he is an officer of General Packaging Services, Inc.

This is an application by Visual Sounds, Inc., the debtor-in-possession, to require that Harold Israelson, Esq. and General Packaging Services, Inc., herein referred to as GPS, turn over to it certain shares of stock of a corporation known as General Magnetic Tape, Inc., herein referred to as GMT, which are now in the possession of said Harold Israelson, and to stay an action commenced by GPS in the Supreme Court of the State of New York for a declaratory judgment that it is entitled to possession of said shares of stock.

The applicant apparently seeks to have the Court exercise summary jurisdiction in granting the relief requested. GPS opposes the application on the following grounds:

1. That the debtor does not have either actual or the right to possession of said shares of stock of GMT, which is essential to the exercise of the Courts summary jurisdiction.

2. That pursuant to an agreement of sale between the debtor and GPS, the debtor has no right to the possession of said shares of stock of GMT until it has paid the full amount of the consideration required by said agreement. The agreement is dated October 2, 1973 and modified a prior agreement between the said parties for the sale and purchase of said shares of stock. The agreement requires that the debtor pay $75,000 for the purchase of said shares, $50,000 of which was to be paid on April 1, 1974 and the

balance of $25,000 in 13 installments, the first of which for $1,000 was to be paid on May 15, 1974 and 11 installments of a similar amount to be paid on the 15th day of each successive month thereafter, with a final payment of the balance on the 15th day of May, 1975.

To insure the performance of said agreement, all of the shares of stock of GMT were deposited with Harold Israelson, Esq. and were to be delivered to the debtor only upon its having made the final payment of the agreed purchase price as provided by said agreement. None of the installments required by said agreement have been paid. The debtor has never assumed said executory agreement.

3. Possession of said shares of stock of GMT are neither necessary nor essential to the continued operation of the debtor.

Prior to April 8, 1974, the date on which the petition herein was filed, the debtor was engaged in the business of producing and distributing sound recordings for business and industrial use. The possession of the stock of GMT is neither essential nor necessary to the operation of said business. But, more important, it appears that the debtor has since the petition herein was filed abandoned its business. It formerly had a place of business at 322 West 48th Street, New York City. It no longer occupies this place of business. On the lobby directory of the building located at 3 West 57th Street in which the offices of Friedman, Fischman & Chikofsky, attorneys for the debtor are located, the debtor is listed as being in the same office as said attorneys. It has no listing in the current telephone directory.

The good faith in filing the petition herein is seriously questioned. It is doubtful that the purpose of the petition was the rehabilitation of the debtor, the object of Chapter XI, especially in view of the fact that the debtor

has apparently ceased to operate as a going business. Rather, there is reason to believe that the real purpose of the petition was the intent of a few individuals who dominate the debtor to grab GMT. GMT has assets of substantial value and is a going business producing substantial income. Since none of the purchase price to be paid for the shares of GMT, required by the October 2, 1973 agreement has been paid, they would acquire GMT for nothing.

Under the October 2, 1973 agreement GPS believes that the debtor has no right to GMT unless the full purchase price is paid. Requiring delivery of the shares of GMT to the debtor would constitute a violation of said agreement and a violation of GPS rights under said agreement. The sale of the shares of GMT to the debtor has not been consummated, since delivery has not been made. Where a buyer becomes insolvent prior to delivery of the goods sold, the seller has the right under the laws of the State of New York to stop delivery.

Property which rightfully belongs to GPS will be unlawfully and inequitably appropriated for the satisfaction of obligation of the general creditors of the debtor. GPS believes that the stock of GMT should not be seized without a full plenary action to establish the rights of the parties and that the action now pending in the New York Supreme Court should be permitted to continue for such purpose.

Knowledge of the events which preceded this application are essential to its understanding.

In or about March 1972 GPS and the debtor entered into an agreement for the sale and purchase of all of the outstanding stock of GMT. The price was $250,000 in cash to be paid in five installments of $50,000 each. The first installment was to be paid when the shares were deli-

vered, which was on or about April 1, 1972. The other four installments, also for $50,000 each, were to be paid April 15, 1973, April 15, 1974, April 15, 1975 and April 15 1976. The agreement contained a provision permitting the debtor to demand a refund with respect to any installment of the purchase price, if the profits of GMT for the preceding year were less than a fixed amount. These refunds would have been subject to repayment in the event that future profits exceeded certain fixed amounts. Also, if the profits exceeded certain levels, additional consideration was to be paid in the form of the debtor stock. To assure that this agreement would be carried out EDWARD GODDARD, one of the principals of GPS was to be the Treasurer of GMT and FREDERICK N. KINNE, the other principal of GPS was to be the Treasurer and a Director of the debtor.

Early in 1973, JOHN GORDY, President of the Debtor and ROBERT POSSEHL, an alleged Vice-President of the debtor, forced EDWARD GODDARD to resign as Treasurer of the debtor, so that he would not have access to the books and records of GMT. The said persons also sought to remove FREDERICK N. KINNE as Treasurer of the debtor, held Director's meetings without notice to him and conducted the business without his knowledge or consent. The profits of GMT were misrepresented. A bank at which one of the notes given by debtor in payment of the GMT stock had been discounted was told that the debtor did not intend to pay the note, since GMT had not made sufficient profits. All of these incidents and others finally led to the commencement of a law suit in or about April 1973 by GPS and FREDERICK KINNE against the debtor, JOHN GORDY and ROBERT POSSEHL in the Supreme Court of New Jersey, Bergen County. The relief demanded in that action included (1)

that the debtor, JOHN GORDY and ROBERT POSSEHL be enjoined from diverting any funds from GMT to the debtor in violation of the sale purchase agreement, (2) enjoining JOHN GORDY from further participation or interference with the management of the business of VSI and GMT, (3) appointing a suitable custodial receiver to manage the assets and business of VSI and GMT, (4) requiring the debtor to return GMT stock to GPS.

Subsequently, the parties entered into the so-called settlement agreement dated October 2, 1973, a copy of which is annexed to the application herein.

This agreement remains wholly unexecuted. Whether the debtor ever intended to carry out this agreement is a question which need not be answered now. The present application seeks to nullify the agreement. The agreement is actually a modification of the prior purchase and sale agreement entered into between the parties in or about March 1, 1972. The modification eliminated all of the complex conditions of the original agreement purporting to condition the price of the GMT shares upon GMT profits, which GPS claimed had been misrepresented, and the facts with respect to which they had been denied access. It provided that the debtor would pay GPS $75,000 in installments as herein above set forth. To assure that such payment would be made, the parties expressly agreed that possession of the stock would be given to Harold Israelson, Esq. and would be delivered to the debtor only when all installment payments provided by the modified sale-purchase agreement had been made. Consummation of a sale requires delivery. Under the laws of the State of New York, insolvency of the buyers prior to delivery, gives the seller the right to stop delivery unless full payment is received.

By agreement between the parties, delivery of the shares of stock was not to be made until all installments of the purchase price required by said agreement were paid. Harold Israelson, Esq. was made custodian of the stock until such time as the debtor was entitled to have the shares of stock delivered, so as to assure such delivery and at the same time protect the rights of GPS in the event the purchase price was not paid to it.

The application for a Turnover Order should be denied.

The request for a stay of the action commenced in the Supreme Court of the State of New York for a declaratory judgment, that General Packaging Services, Inc. is entitled to the stock of General Magnetic Tape, Inc. should be denied. No compelling reason for such stay has been shown.

/s/ Edwin Goddard
EDWIN GODDARD

NOTARIZED

Affidavit of Harold Fischman

STATE OF NEW YORK)
)
COUNTY OF NEW YORK)

HAROLD FISCHMAN, being duly sworn, deposes and says:

I am a member of the firm of Friedmann, Fischman & Chikofsky, attorneys for the debtor herein, and am the secretary of the debtor as well.

This affidavit is submitted in reply to the affidavit of Edwin Goddard, dated September 4, 1974, and the undated memorandum of General Packaging Services, Inc. served in opposition to the debtor's application for a turnover order.

The statement of facts included in the memorandum being submitted simultaneously herewith is incorporated herewith by reference under penalty of perjury. The receipt dated October 2, 1973 for delivery of the shares of General Magnetic Tape Co., Inc. (GMT), is attached hereto and made a part hereof as Exhibit A.

The affidavit of Edwin Goddard, dated September 4, 1974 and the undated memorandum of General Packaging Services, Inc. (GPS) submitted in opposition to the debtor's application is intentionally and maliciously false and fraudulent and filed with an intent to deceive and mislead this Court in that:

1. It does not inform this Court that $100,000 was paid by Visual Sounds, Inc. (VSI) to GPS when $50,000 was paid on or about March 1, 1972 and $50,000 was paid on or about April 15, 1973.

2. When it states that the shares of GMT were not delivered, and when it states that "the sales of the shares of GMT to the debtor has not been consummated since

delivery has not been made" (Affidavit, page 3, line 10), when in fact, delivery was made on or about March 1, 1972.

3. When it states that "Edwin Goddard, one of the principals of GPS, was to be the treasurer of GMT, and Frederick N. Kinne, the other principal of GPS was to be the treasurer and a director of the debtor" (Affidavit, page 4, line 5), when such an agreement was never made and, in fact, would have been violative of corporative law and the rules and regulations governing public corporations.

4. When they failed to inform this Court that two lawsuits were begun on behalf of the debtor against GPS and others and only informed the Court of the lawsuit brought by themselves.

5. When it attempts to construe the settlement agreement as "a modification of the prior purchase and sale agreement entered into between the parties in or about March 1, 1972" (Affidavit, page 5, line 8) when the document is entitled "Settlement Agreement and Releases" and constitutes a release of the obligations of the March 1, 1972 agreement.

6. When it states that "the shares of stock of GMT are in possession of Harold G. Israelson, Esq., a disinterested third-party, pursuant to a purchase agreement between GPS and the debtor, dated October 2, 1973 (this agreement is sometimes referred to as the settlement agreement)." (Memo page 1, line 9), when the October 2, 1973 agreement is a settlement agreement, entitled a settlement agreement and is not a purchase agreement.

7. When it states "the October 2, 1973 agreement provides for the purchase of GMT stock by the debtor" (Memo page 4, line 13) and the stock was in fact purchased and delivered on or about March 1, 1972 and the

October 2, 1973 agreement has nothing to do with the purchase of stock and was purely a settlement agreement of three lawsuits.

8. When it denies that GMT constitutes a vital and substantial asset of the debtor necessary to the operation of the debtor (Affidavit page 2, paragraph 3) when GPS and its officers were intimately related to the affairs of VSI and know that over $100,000 was paid to them for its ownership and many hundreds of dollars were expended in the operation of GMT.

WHEREFORE, applicant prays for the turnover order requested in its application and that the stay be continued.

HAROLD FISCHMAN

NOTARIZED

Receipt for Stock
(Annexed to foregoing Affidavit)

October 2, 1973

The undersigned acknowledges receipt of 140 shares of common stock and 250,000 shares of 6% non-cumulative preferred stock of General Magnetic Tape to be held by me, as Custodian, pursuant to the provisions of a stipulation of settlement of even date between Visual Sounds, Inc., John Gordy, General Packaging Services, Inc., Frederick N. Kinne and Edwin Goddard.
Dated: New York, N.Y.

/s/ Harold G. Israelson
HAROLD G. ISRAELSON

STATEMENT OF FACTS
(Annexed to foregoing Affidavit)

On or about March 1, 1972, VSI, debtor, bought all of the issued and outstanding shares of GMT from General Packaging Services, Inc. (hereinafter referred to as GPS), a New Jersey corporation.

On or about March 1, 1972, VSI paid to GPS $50,000.

On or about March 1, 1972, GPS delivered to VSI all of the issued and outstanding shares of GMT to VSI in good form for transfer, with assignments attached to the certificates. The aforesaid sale and transfer of shares was complete and unconditional. It was accomplished pursuant to a contract of sale which called for additional and seriatum payments from VSI to GPS predicated upon the earnings, if any, of GMT. The aforestated contract of sale vested title in VSI and made no provision for the return of the shares under any conditions, except if VSI chose to rescind the transaction within the first year.

On or about March 1, 1972, the shares of GMT, delivered by GPS to VSI, were cancelled and new certificates of GMT were issued to VSI registered in the name of VSI and delivered into the possession of VSI.

On or about April 23, 1973, GPS and Frederick N. Kinne brought an action in the Superior Court of New Jersey against VSI, et al., principally seeking rescission of the March 1, 1972 sale. On or about April 25, 1973, VSI brought an action in the United States District Court, Southern District of New York, against GPS, Edward N. Kinne and Edwin M. Goddard seeking repayment to them of the $50,000 paid over to GPS on March 1, 1972 in accordance with the terms of the agreement of sale. On or about April 1974, VSI brought a lawsuit in the Superior Court of New Jersey against GPS and others, prin-

cipally seeking repayment of an additional $50,000 illegally paid to GPS, on or about April 15, 1973 presumably paid pursuant to the terms of the March 1, 1972 contract.

The above lawsuits were settled on October 2, 1973 and the settlement agreement and releases are appended to the debtor's application for a turnover herein.

Pursuant to paragraph 5(a) of the settlement agreement, all of the issued and outstanding shares of stock of GMT was delivered to Harold G. Israelson, Esq. who was to "act merely as a gratuitous custodian of such stock certificates of GMT and not as an escrow agent, nor as a pledgee, nor as a guarantor, nor in any other manner or capacity, but solely as a custodian of those stock certificates.

It is further clearly stated that "the said custodian account shall not be, nor considered to be, nor construed to be a security interest, collateral, pledge, lien or encumbrance of any kind, nature or description; and all of the rights, title and interest of VSI in and to such shares, shall be and continue to be clear of any all liens and encumbrances for any and all purposes whatsoever.

On October 2, 1973, the shares of GMT were delivered to Mr. Israelson "pursuant to the provisions of a stipulation of settlement of even date."

Decision on Motion for Turnover of Stock

APPEARANCES:

FRIEDMANN, FISCHMAN & CHIKOFSKY, ESQ.,
Attorneys for Debtor
For the Motion

MILLER & BUSH, ESQ.,
Attorneys for General Packaging Services, Inc.
In Opposition to the Motion

ASA S. HERZOG, Bankruptcy Judge:

The debtor moves to compel Harold G. Israelson, Esq., and General Packaging Services, Inc. (General), to turn over 140 shares of common and 250,000 shares of preferred stock of General Magnetic Tape Co. (Magnetic Tape). No evidence was adduced, the parties resting on the moving and answering papers.

From those papers and the exhibits attached thereto, the following facts appear: In March 1972, the debtor and General entered into an agreement for the sale by General to the debtor of all of the outstanding stock of Magnetic Tape. The purchase price was $250,000 in cash to be paid in five installments of $50,000 each, the first installment to be paid on delivery and the remaining installments on April 15, 1973, and on April 15 of succeeding years. The agreement had provisions for refund if profits were less than a fixed amount and for repayment of those refunds if profits thereafter exceeded certain fixed amounts. If profits exceeded certain levels, additional consideration was to be paid in the form of stock of the debtor. One of General's principals was to become a

Treasurer of Magnetic Tape and another to become Treasurer of the debtor.

Apparently, things did not go well thereafter; disagreements arose and incidents occurred; and in April 1973 an action was brought by General and a principal against the debtor and two of its principals, in the Supreme Court of New Jersey, Bergen County, seeking, *inter alia*, the return of the Magnetic Tape stock. Thereafter, and on October 2, 1973, the parties entered into a "settlement" agreement and the resolution of this turnover motion depends upon the construction of that agreement.

The agreement first recites that General "sold" to the debtor the stock in question and that as a result of "differences and problems," lawsuits had been commenced and that the parties have agreed to resolve their differencs.

Paragraphs 1 and 2 of the agreement provide for releases among the parties and paragraph 3 provides for execution of necessary documents to effect dismissal of the pending lawsuits .

Paragraph 4 provides that as "a condition precedent to the effectiveness" of the agreement: (a) The debtor agrees to pay a certain promissory note for $50,000 issued pursuant to the original agreement; (b) the $100,000 paid by debtor under the original agreement shall continue to belong to General; (c) the principals of General shall return all stock received from the debtor; and (d) debtor will pay to General $25,000 at the rate of $1,000 per month evidenced by promissory notes.

Paragraph 5(a) provides that all the stock of Magnetic Tape will be delivered to the respondent Israelson, as "gratuitous custodian" and not as escrow agent, pledgeholder guarantor or in any other capacity. The stock is to be returned to debtor upon payment of the $25,000

provided for in paragraph 4(d). All the "rights, titles and interests "of the debtor in said shares shall be and continue to be" clear of any and all liens and incumbrances for any and all purposes whatsoever. Paragraph 5(b) provides that General and its principal will be held harmless with respect to any claim on personal guarantees made by them to creditors of the debtor and Magnetic Tape.

Paragraph 6 provides that the settlement agreement "will completely terminate all relationships and business understandings and agreements" theretofore had, and "fully, completely and finally terminated, ceases and abrogates any understandings, agreements, instruments, documents or pacts among any of the parties hereto, whether the same be oral or written, express or implied."

Thereafter, General and its principals commenced a suit against debtor and Israelson in the New York Supreme Court alleging the sale of the stock pursuant to the original agreement, the institution of suits, the settlement agreement and the breach thereof by debtor in failing to pay the note for $50,000 or any of the installments of the additional $25,000. The prayer for relief seeks a declaration of breach of the settlement agreement and a direction to Israelson to turn over the Magnetic Tape stock.

The respondents object to the summary jurisdiction of this court to direct Israelson to turn over the stock on the ground that the bankruptcy court lacks jurisdiction where the property in dispute is not in the possession of the bankruptcy court. But this overlooks § 311 of Chapter XI of the Act which gives the court exclusive jurisdiction of the debtor and his property wherever located. This section confers exclusive jurisdiction on the bank-

ruptcy court to determine controversies concerning property either owned by the debtor, or in the actual or constructive possession of the court. *Pasadena Investment Company v. Weaver*, 376 F.2d 175 (9th Cir. 1967); *Lloyd v. Stewart & Nuss, Inc.*, 327 F.2d 642 (9th Cir. 1964).

Therefore, if on the date the Chapter XI petition was filed the debtor had either title to the Magnetic Tape stock *or* if on that date the stock was in the constructive possession of this court, then summary jurisdiction lies.

Under the original agreement both title and possession passed to the debtor. By virtue of the settlement agreement, the debtor surrendered possession to the "custodian." The settlement agreement is silent on reversion of title in General and its principals. While the settlement agreement may constitute a novation whereby the original contract was extinguished and the settlement agreement substituted in its place, the settlement agreevery carefully avoids any mention of title or ownership of the stock revesting in General or its principals.

In point of fact, the settlement agreement provided only that upon payment of the $25,000 referred to in paragraph 4(b) thereof, "the stock certificates shall be returned promptly to VSI," the debtor herein. Nowhere in the agreement is it provided that upon default of payment stock is to be returned to General.

I cannot construe the ambiguous settlement agreement as intending to divest the debtor of title to the stock. The intention of the parties as I read it from the provisions of the agreement was to safeguard the stock until the new terms of payment were met. The stock was placed in the hands of a custodian so that debtor could work no mis-

chief with them. The stock could not be encumbered or otherwise disposed of by the debtor until it complied with the terms of the new agreement respecting payment. There is nothing in the agreement as to who may vote the stock or as to who will manage the affairs of the Magnetic Tape Company. It appears that the debtor is presently operating the business of Magnetic Tape and has been in continued control and possession of the business since the original purchase agreement was entered into. In fact, respondents claim that operation of Magnetic Tape now constitutes the debtor's sole activity.

Since I find that title to the stock was in the debtor when the Chapter XI petition was filed, it follows that this court may exercise summary jurisdiction to determine all controversies relating to that stock.

The question of constructive possession is less clear. The general rule is that where a third person holds possession of debtor's property and makes no adverse claim to it, that person will be subject to summary jurisdiction even though others make claims adverse to the debtor. *In Matter of Goldman*, 5 F. Supp. 973 (S.D.N.Y., 1933), a strangely parallel case, certain shares of stock were delivered to a third person to be held by him in escrow for the bankrupt's benefit and account and to be turned over under certain prescribed conditions. Just before the time fixed for delivery to the bankrupt, the other parties to the contract instituted suit for recission and restoration of the stock alleging they had been induced to make the "settlement" by fraud. Judge Patterson held

> "There can be no doubt that under such circumstances the bankruptcy court has the power to order the property turned over to the trustee and to stay further proceedings by the adverse claimants in the state court."

The problem here lies in the nature of the escrow. The settlement agreement is clear in designating Israelson as a "gratuitous custodian." A gratuitous bailee is defined in Black's Law Dicitionary (3d Edition) as:

> "Another name for a depositum or naked bailment, which is made only for the benefit of the bailor and is not a source of profit to the bailee."

I read "gratuitous custodian" to mean the same as a "gratuitous bailee." Israelson's function is merely to act as a "depositum" or repository for the stock and to deliver the stock to the debtor upon payment of the $25,000. As already noted there is no provision in the agreement for delivery of the stock to General or its principals under any circumstances. I conclude that Israelson is indeed a bailee for the debtor and since he makes no claim of interest, he is subject to the orders of the bankruptcy court. See *Buss v. Long Island Storage Warehouse, Inc.*, 64 F.2d 338 (2d Cir. 1933).

In any event, even though jurisdiction based on constructive possession be said to be doubtful because of the ambiguous position of the debtor as bailor, I am satisfied that jurisdiction based on title rests on solid ground.

The motion will be granted. Settled order in conformity with the foregoing on 5 days' notice, the order to contain a provision staying execution for 10 days after entry and if an appeal is taken within said period, then until final disposition of such appeal.

Dated: New York, New York
October 10, 1974

/s/ Asa S. Herzog
ASA S. HERZOG
Bankruptcy Judge

Order Directing Turnover of General Magnetic Tape Co., Inc. Stock

The debtor herein having moved this Court by Order to Show Cause dated August 13, 1974, for an order requiring Harold G. Israelson, Esq., to turn over and surrender certain property consisting of 140 share of common and 250,000 shares of preferred stock of General Magnetic Tape Co., Inc., and the same having come on to be heard before me on September 5, 1974,

NOW, upon the Order to Show Cause dated August 13, 1974 and the Application of Visual Sounds, Inc., debtor, by its attorneys, Friedmann, Fischman & Chikofsky, dated August 12, 1974, and the Affidavit of Edwin Goddard dated September 4, 1974 in opposition thereto, and the Affidavit of Harold Fischman, Esq. dated September 20, 1974 in reply thereto, and upon all the proceedings heretofore had herein and after due deliberation having been had thereon, and it appearing to my satisfaction that the shares of General Magnetic Tape Co., Inc., hereinafter described, are in the possession of Harold G. Israelson and that said Harold G. Israelson has no claim thereto, and that the debtor Visual Sounds, Inc. is entitled to immediate possession thereof, it is

ORDERED, that the motion be and the same hereby is granted in all respects, and it is further

ORDERED, that Harold G. Israelson be and he hereby is directed to deliver to Visual Sounds, Inc., debtor herein, 140 shares of common and 250,000 shares of preferred stock of General Magnetic Tape Co., Inc., and it is further

ORDERED, that execution of the within is stayed for a period of ten (10) days after entry hereof and that if

an appeal is taken from the within order, execution shall be stayed until final disposition of such appeal.

Dated: New York, New York
October , 1974

ASA S. HERZOG,
Bankruptcy Judge

Opinion of Judge Bonsal

MILLER & BUSH, ESQS.
405 Lexington Avenue,
New York, N.Y. 10017 and

ROBERT ALAN VORT, ESQ.
1180 Raymond Blvd.,
Newark, New Jersey 07102
Attorneys for Appellant General
Packaging Services, Inc.

ROBERT ALAN VORT, ESQ., On the Brief
IRVING T. BUSH, ESQ., Of Counsel

FRIEDMANN, FISCHMAN & CHIKOFSKY, ESQS.
3 West 57th Street,
New York, N.Y. 10019
Attorneys for Debtor-Appellee
HAROLD FISCHMAN, ESQ., Of Counsel

BONSAL, D.J.

MEMORANDUM

General Packaging Services, Inc. ("General") appeals from an order of the bankruptcy judge dated October 21, 1974, directing Harold G. Israelson, Esq. to deliver to Visual Sounds, Inc. ("Visual"), the debtor in possession, 140 shares of common and 250,000 shares of preferred stock of General Magnetic Tape Company, Inc. ("Magnetic").

In March 1972, General and Visual entered into an agreement for the sale to Visual of all of the outstanding shares of Magnetic. The purchase price was $250,000 to be paid in five installments of $50,000 each, the first installment to be paid on delivery and the remaining installments on April 15, 1973, and on April 15 of suc-

ceeding years. The agreement contained provisions for adjustment of the purchase price depending on the profits of Magnetic. The shares of Magnetic were delivered to Visual, with assignments attached to the certificates. Subsequently, these certificates were cancelled and new certificates registered in the name of Visual were issued and delivered to Visual. It appears that upon delivery of the shares Visual paid General $50,000 and that another $50,000 was paid on or about April 15, 1973.

Dispute arose between the parties, and in April 1973 an action was brought by General against Visual in the Supreme Court of New Jersey, Bergen County, seeking *inter alia,* the return of the Magnetic stock. Visual thereafter commenced actions seeking recovery of the $100,000 paid to General.

On October 2, 1973, the parties entered into a "settlement agreement." Paragraph 4 of the agreement provides that as "a condition precedent to the effectiveness" of the agreement: (a) Visual agrees to pay a certain promissory note for $50,000 issued pursuant to the original agreement; (b) the $100,000 paid by Visual under the original agreement shall continue to belong to General; (c) the principals of General agree to return all stock received from Visual; and (d) Visual agrees to pay $25,000 at the rate of $1,000 per month evidenced by promissory notes. Paragraph 5(a) provides that all of the Magnetic stock will be delivered to Israelson, who will act merely as a gratuitous custodian . . . and not as an escrow agent, nor as a pledgeholder, nor as a guarantor, nor in any other manner or capacity, but solely as custodian of those certificates," and will be "returned" to Visual upon payment of the $25,000 referred to in paragraph 4(d). "The said custodian account shall not be, nor considered to be, nor construed to be a security

interest, collateral, pledge, lien or encumbrance of any kind, nature or description; and all of the rights, titles and interests of [Visual] in and to such shares shall be and continue to be clear of any and all liens and encumbrances for any and all purposes whatsoever."

Visual subsequently filed a petition for arrangement under Chapter XI. General thereafter commenced an action in the Supreme Court of New York against Visual and Israelson, seeking a direction to Israelson to turn over the Magnetic stock on the ground that Visual had breached the settlement agreement by failing to make the payments required under paragraph 4. Visual did not appear in the state court action, but sought a turnover order in the bankruptcy court.

The learned bankruptcy judge determined that resolution of the turnover action depended on construction of the settlement agreement. Although the judge characterized the agreement as "ambiguous," it does not appear that either of the parties sought to introduce oral testimony as an aid to construction of the agreement and the judge pointed out in his opinion that the parties rested on the moving and answering papers. Finding that Visual had title to the Magnetic stock at the time the Chapter XI petition was filed, the bankruptcy judge exercised summary jurisdiction and directed Israelson to turn over the Magnetic stock to Visual. In addition, the judge indicated that summary jurisdiction might also be predicated on constructive possession, although he found this to be a more questionable basis than title.

On appeal, General challenges the jurisdiction of the bankruptcy judge to proceed summarily, contending that it has a substantial adverse claim of ownership which can be determined only in a plenary action.

Pursuant to section 311 of the Bankruptcy Act, 11 U.S.C. §711, a court of bankruptcy has summary jurisdiction to determine controversies involving property either owned by the debtor or in the possession of the court at the time the Chapter XI petition was filed. *Pasadena Investment Co. v. Weaver*, 376 F.2d 175 (9th Cir. 1967); *see* 8 Collier on Bankruptcy ¶3.02, at 181 (14th ed. 1971). Where, however, possession is held by a third person, an adverse claim of ownership may not be summarily adjudicated unless by consent or unless the claim is merely colorable. *See* 8 Collier on Bankruptcy ¶3.02, at 182 (14th ed. 1971); *cf. In re Schoenberg*, 70 F.2d 321 (2d Cir. 1934). An adverse claim "is to be deemed of a substantial character when the claimant's contention 'discloses a contested matter of right, involving some fair doubt and reasonable room for controversy,' . . . in matters either of fact or law and is not to be held merely colorable unless the preliminary inquiry shows that it is so unsubstantial and obviously insufficient, either in fact or law, as to be plainly without color or merit, and a mere pretense." *Harrison v. Chamberlin*, 271 U.S. 191, 195 (1926).

It appears that General never raised its adverse claim of ownership in the proceedings before the bankruptcy judge. Having apparently overlooked ownership as a basis for summary jurisdiction under Chapter XI, General seems to have rested its case on the claim that it had a contractual right to require that Israelson retain possession of the Magnetic stock until full payment of the purchase price had been made. However, this Court is of the opinion that no useful purpose would be served by remanding the case to the bankruptcy judge for an express determination as to whether General's claim of ownership is colorable or substantial, because implicit in

the bankruptcy judge's finding that Visual had title to the Magnetic stock is a determination that General's claim of ownership is colorable only.

The original agreement between Visual and General gave Visual both title to and possession of the Magnetic stock. General's contention that the filing of Visual's suits for return of purchase monies after General had commenced a suit for return of the Magnetic stock automatically "revested" title in General is concededly novel as a matter of law. The Court finds no merit in this argument, particularly since General continued to retain a substantial portion of the purchase price. Retention of the $100,000 paid by Visual under the original contract was also a provision of the settlement agreement.

Pursuant to the settlement agreement, Visual surrendered possession of the Magnetic stock to the "custodian," who asserts no interest. However, the shares apparently remained registered in Visual's name. As noted by the bankruptcy judge, the settlement agreement is silent on reversion of title in General, and nowhere is it provided that the stock is to be delivered to General if Visual defaults on payment. The provision that the "custodian account shall not be, nor considered to be, nor construed to be a security interest, collateral, pledge, lien or encumbrance of any kind, nature or description" suggests that General was to have no security interest in the stock to secure payment by Visual.

Moreover, certain language in the agreement indicates the understanding of the parties that Visual had title to the Magnetic stock. The agreement provides that the stock shall be "returned" to Visual upon payment of the $25,000 referred to in paragraph 4(d) and states that "all of the rights, titles and interests of [Visual] in and to such shares shall be and continue to be clear of any

and all liens and encumbrances for any and all purposes whatsoever." Visual is apparently operating the business of Magnetic and has been in continued control and possession of the business since the original purchase agreement was entered into. Indeed, Visual maintains that its major asset is the ownership and operation of Magnetic.

Whatever rights General may have under the settlement agreement, its claim to ownership of the Magnetic stock is colorable only. The bankruptcy judge had jurisdiction to proceed summarily, and General has not shown that his turnover order was otherwise in error. The order appealed from is therefore affirmed.

Settle order on notice.

Dated: New York, N.Y.
March 6, 1975

/s/ Dudley B. Bonsal
DUDLEY B. BONSAL
U.S.D.J.

Order

An appeal having been taken to this court by General Packaging Services, Inc., the party affected by the order appealed from herein from the order of the Bankruptcy Judge entered in this case on the 21st day of October, 1974 directing the turnover of General Magnetic Tape Co., Inc. stock and said appeal having been argued by Robert Alan Vort, Esq., of counsel for the appellant General Packing Services, Inc., and by Harold Fischman, Esq. of counsel for the debtor; and upon all the proceedings heretofore had herein and due deliberation having been had thereon and upon the memorandum decision of this court dated March 6, 1975, it is

ORDERED, that the order dated October 21, 1974 issued by the Honorable Asa S. Herzog, Bankruptcy Judge, be and the same is hereby affirmed; and it is further

ORDERED, that Harold G. Israelson be and he hereby is directed and instructed to deliver to Visual Sounds, Inc., debtor, 140 shares of common and 250,000 shares of preferred stock of General Magnetic Tape Co., Inc. on or before the expiration of ten (10) business days from the date of service of a certified copy of the within order, and it is further

ORDERED, that service of the within order on Harold G. Israelson, 521 Fifth Avenue, New York, N.Y. 10017 and Miller & Bush, Esqs., 405 Lexington Avenue, New York, N.Y. 10017, attorneys for General Packaging Services, Inc., by certified mail, return receipt requested, be deemed good and sufficient service hereof.

Dated: New York, N.Y.
March 21st, 1975

/s/ Dudley B. Bonsal
DUDLEY B. BONSAL
United States District Judge

Notice of Appeal

NOTICE is hereby given that General Packaging Service, Inc., hereby appeals to the United States Court of Appeals for the Second Circuit from the order entered in this action on March 25, 1975, per Hon. Dudley B. Bonsal, U.S.D.J., which affirmed the turnover order dated October 21, 1974 of this Court, per Hon. Asa S. Herzog, Bankruptcy Judge.

ROBERT ALAN VORT
1180 Raymond Boulevard,
Newark, N.J.
and
MILLER & BUSH
405 Lexington Avenue,
New York, N.Y.
Attorneys for General
Packaging Service, Inc.

By:
IRVING T. BUSH

Dated: New York, N.Y.
March 27, 1975